

## **CHAPTER 7: SERVICING PERMANENT LOANS**

### **7.1 INTRODUCTION**

This chapter is designed to serve as a best practice guidebook for servicing of GRRHP loans. While it establishes minimum servicing standards, the Agency expects lenders to service the loans according to the same standards of excellence as other properties in the lender's portfolio.

#### **Key Topics in this Chapter**

- Section 1: Servicing Goals and Objectives
- Section 2: General Servicing Requirements
- Section 3: Asset Management
- Section 4: Special Servicing

### **SECTION 1: SERVICING GOALS AND OBJECTIVES**

#### **7.2 OBJECTIVES**

In establishing servicing standards for GRRHP loans, the Agency has three major objectives:

- Protecting the Value of the Asset;
- Protecting the Tenants; and
- Protecting the Government's Interest.

#### **7.3 PROTECTING THE VALUE OF THE FINANCIAL ASSET**

The financial asset includes both the loan and the security property that serves as collateral. Protecting the value of the asset ensures that the property will remain available as affordable housing for the term of the loan and protects the financial interests of the lender and the Agency. The lender has the primary responsibility with the borrower for protecting the value of the asset through regular monitoring, inspections of the property, and management of reserves and escrow accounts.

## **7.4 PROTECTING THE TENANTS' RIGHTS**

By statute, GRRHP units must be available to persons of low and moderate income. Tenants who reside in GRRHP properties have the right to remain in a rental unit even if their income increases, so long as they meet the requirements of the lease. Moreover, the Agency has determined to keep units affordable by controlling unit rents. These goals are set forth in Chapter 8. The lender must ensure that the occupancy requirements, rent restrictions, and tenant protections are met by the borrower throughout the term of the guarantee, or in the case of the income restrictions, the original mortgage term.

## **7.5 PROTECTING THE GOVERNMENT'S INTERESTS**

As a condition for lender approval under [7 CFR Part 3565, subpart C], the lender must operate under a plan for originating and servicing GRRHP loans. The Agency expects that the lender will service the loans according to the same standards as it services all other multifamily loans in its portfolio. The requirements for the origination and servicing plan that establishes the lender's policies and procedures for servicing multifamily loans can be found in Chapter 2.

The Agency servicing standards are designed to preserve the asset and protect the interests of the government. This includes, but is not limited to:

- Minimum requirements for annual reviews of the physical and financial conditions of the property.
- Reporting requirements designed to keep the Agency informed of key indicators of the GRRHP portfolio.
- Minimum standards for special servicing for loans that are delinquent or in default.

## **SECTION 2: GENERAL SERVICING REQUIREMENTS**

### **7.6 FUNDS MANAGEMENT**



#### **A. Collecting and Processing Borrower Payments**

The lender will collect and apply borrower payments on the loan in accordance with Generally Accepted Accounting Practices. At a minimum, such standards should meet the requirements established by Fannie Mae or Freddie Mac for similar properties.

#### **B. Escrow and Reserve Account Management**

The lender is responsible for proper maintenance of the borrower's escrow accounts. Escrows shall include escrow accounts established for both hazard (fire) insurance and flood insurance to reserve the monthly share of annual property tax and property

insurance payments. In addition, each property must have a reserve account for replacement to receive monthly deposits for projected replacement of appliances, furnishings, equipment, and major repairs.

### **C. Interest Credit**

The Interest Credit will be paid following the January 1 of the year in which the project has reached occupancy standards and the Loan Note Guarantee is converted to the Final Loan Note Guarantee. The interest credit calculation and the request will be part of the annual report provided to the Agency State Office. The State Office will review the calculation for accuracy and then forward the document on to the Finance Office for processing. The interest will be calculated from the date of the conversion to the Final Loan Note Guarantee to the end of the year.

### **D. Approval of Reserve Releases**

#### ***1. Agency Recommended Approval Requirements***

Lenders must establish their own reserve management protocols in the lender servicing plan. The procedures should include, at a minimum, the following:

- **Lender approval** of releases of funds from required reserve accounts.
- **Documentation of completed work.** Most requests should be processed on a post-approval basis, once the work is completed or expenses paid and the required documentation submitted. While the Agency does not have specific requirements for verification of expenses, the lender should ensure that reserve funds are used for eligible purposes. Documentation should include original receipts and a borrower certification that the work described has been completed.

## ***2. Approval of Structural Repairs***

The Agency recommends pre-approval by the lender for repairs involving structural work. A review and approval of the plans and specifications for such work may also be warranted.

## ***3. Obtaining Bids in the Use of the Reserve Account***

Lenders should require borrowers to obtain bids on major repairs, construction projects, or purchases. A recommended standard is three written bids for any single purchase or project that exceeds \$10,000. Borrowers should be required to justify any bid accepted that is higher than the lowest bid.

## ***4. Minimum Recommended Replacement Reserve Levels***

Required deposits to a replacement reserve account should be determined by the lender through a life cycle cost analysis and capital needs assessment. These amounts should be reviewed annually, and modifications made if the reserve deposits are not sufficient to address long term replacement needs. A balance of \$1,000 per unit is recommended by the Agency as a minimum level for the reserve account. This will ensure availability of funds for unexpected repairs or temporary needs. This level should be achieved by the end of the third full year of occupancy. Any drop below that level, once it is reached, should be reported to the Agency as part of the annual report on the property.

## ***5. Eligible Uses of Reserve Funds***

Reserve funds should be used for the repair and replacement of depreciable physical property. The lender has the discretion to approve or disapprove the use of reserve funds, even if an item is permitted by Agency guidance, if the lender feels it is in the best financial interest of the property. A list of eligible uses is suggested below. Items permitted by Fannie Mae and Freddie Mac as eligible reserve release items will also be considered eligible.

Replacement items should be at least comparable in quality to items approved at the time of the original construction of the property, and in accordance with the initial plans and specifications. When replacing obsolete or broken appliances, the purchase of new energy efficient models should be encouraged.

On an annual basis, the lender must submit to the Agency a summary of the reserve withdrawal requests made and related work inspection reports for the prior year.

While enhancements to the property such as a personal computer or software may be considered for funding, items generally considered routine maintenance items and capital improvement items should be ineligible for funding from the replacement reserve account. The Agency may require a lender to justify any release of reserve funds for these purposes.

The use of reserve funds is normally considered a categorical exclusion under the Agency's environmental review process, unless the funds will be used in ways that alter the purpose, operation, location, or design of the project. Particular care should be taken that reserve funds are not used to alter the historic integrity of places listed or eligible for listing on the National Register of Historic Places until an environmental review is completed in accordance RD Instruction 1940-G. Lenders must check with the Agency regarding the possible need for an environmental review prior to approval of use of reserve funds.

**Examples — Eligible Uses of Replacement Reserve Account Funds**

- Replacement of refrigerators, ranges, and other major appliances in the dwelling units.
- Replacement of kitchen and bathroom sinks and counter tops, bathroom tubs, water closets, and doors (exterior and interior).
- Major roof repairs, including replacement of sheathing, gutters, downspouts, and eaves or soffits.
- Major plumbing and sanitary system repairs.
- Replacement or major overhaul of central air conditioning and heating systems, including cooling towers, water chilling units, furnaces, stokers, boilers, and fuel storage tanks.
- Overhaul of elevator systems.
- Repaving/resurfacing/sealcoating of sidewalks, parking lots, and driveways.
- Repainting of the entire building exterior or interior common areas.
- Replacement of siding.
- Fire alarms.
- Playground equipment.
- Replacement of exterior (lawn) sprinkler systems.

**E. Approval of Surplus Cash Distribution to the Borrower**

Surplus cash is defined as year-end cash available after the project has met all operating expense and debt service payments, including the required funding of reserves. While a surplus cash distribution to the owner is not restricted as to the amount, Agency

regulations require that the lender ensure that the property be in “good financial and physical condition and in compliance with the regulatory agreement” prior to any distribution of surplus cash.

### ***1. Borrower Request for Distribution of Surplus Cash***

At the end of the project’s fiscal year, the borrower may request the release of surplus cash. As a prior condition for such release, the borrower must submit an annual audited financial statement of the property to the lender (see Paragraph 7.10 A.1. for information on audit requirements). The audit must not have any unresolved findings. Once the lender reviews the statement and certifies that the borrower is in compliance with program requirements, the lender may permit the owner to have access to all or a portion of any surplus cash.

### ***2. Lender Denial of Surplus Cash***

If the borrower has any current or previous unresolved audit findings or any violation of program requirements, the lender may deny access to surplus cash. Exhibit 7-1 gives examples of reasons for denial of surplus cash.

#### **Exhibit 7-1**

##### **Examples of Reasons for Denial of a Year-End Surplus Cash Distribution**

- Fair Housing violations
- Violations of State or local law
- Underfunded reserve accounts
- Failure to submit a budget or other reporting requirements to the lender in a timely manner
- Failure to properly maintain the property
- Failure to comply with the mortgage documents or regulatory agreement

### ***3. Borrower Withdrawal of Surplus Cash Without Lender Approval***

Primary responsibility for control of surplus cash distribution remains with the lender. If a borrower withdraws surplus cash without lender approval, the lender must require the borrower to replace the funds into the proper operating account. If appropriate, the lender may permit repayments in installments as part of a corrective action plan. If the borrower fails to comply, the lender must enforce the technical default clause under the regulatory

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agreement and accelerate the loan. This action must be reported to the Agency in the same manner as a monetary default on the mortgage.

## 7.7 ADDRESSING DEFAULTS AND DELINQUENCIES

Lender actions to remedy delinquencies and defaults must be addressed in the lender servicing plan. Since delinquencies and defaults trigger special servicing actions, it is important to identify when they occur and when the lender must initiate special action. Unless otherwise approved in the servicing plan, the following definitions will apply to delinquencies and defaults.

### A. Delinquencies

For the purpose of this chapter, a project will be considered to be delinquent when the borrower has failed to make the full amount of a required payment on the due date plus any grace period, or fails to comply with non-monetary requirements. Once the loan becomes delinquent, the lender must submit monthly reports to the Agency in accordance with Paragraph 7.10 B.3.

### B. Declaring a Default

For the purpose of this handbook, a lender may declare a default if the delinquency remains outstanding after 30 days from the due date of the payment or written notice of a non-monetary delinquency.



### C. Initiating Special Servicing

Special servicing should be initiated in accordance with Section 4 of this chapter as soon as a default occurs. A workout plan must be submitted to the



#### Example — Initiating Special Servicing — Failure to Pay Mortgage

**1<sup>st</sup> of the month** – The mortgage payment is due.

**15<sup>th</sup> of the month** – The mortgage payment has not been received. A delinquency notice is sent to the borrower warning them of a default under the mortgage documents if a full payment is not received by the end of the month.

**End of the month** – The mortgage payment has not been received, the loan is now in default. The lender informs the borrower of the default and demands payment. Borrower may request a workout plan. If lender agrees to the workout plan, the borrower submits plan to the lender.

**End of the second month** – The lender determines if the plan is acceptable (see Section 4 of this chapter). If so, then the plan is submitted to the Agency. It must be submitted to the Agency by the end of the second month ( 60 days from the date of default ).

Agency no later than 60 days after the date the lender notifies the borrower that they are in default.

Transfer of ownership is normally considered a categorical exclusion under the Agency's environmental review process, unless the transfer will result in an alteration to the purpose, operation, location or design of the project as originally approved.

#### Approval of Ownership Changes

- The **lender** may approve all changes in general or limited partners, or a change that requires a modification to the title.
- The **Agency** must approval all transfers of the entire ownership entity.

## 7.8 TRANSFER OF OWNERSHIP

### A. Liability to the Original Borrower

The lender may not approve an assumption of a GRRHP loan by another party, pursuant to the authorizing statute for the program. Section 538(l) of Title V of the Housing Act of 1949 states: "The borrower under a loan that is guaranteed under this section and under which any portion of the principal obligation or interest remains outstanding may not be relieved of liability with respect to the loan, notwithstanding the transfer of property for which the loan was made."

### B. Changes in the Ownership Entity

The lender must approve all changes in the ownership entity. These include changes in the general partners or in limited partners with a partnership interest greater than 10 percent, or any other change that requires modification of the title.

Prior to approving a change in the ownership entity, the lender must assure that the proposed new partner or entity is not currently on the GSA debarment list and that they are able to obtain a *Form RD 1944-37* clearance on the entity. The lender may access the GSA debarment list online at: <http://www.arnet.gov/epls/>



If an entity is approvable under the above conditions, the lender must determine if the transfer will adversely affect the value or operation of the property for its own purpose. The lender must document the reason for a denial and notify the applicant in writing.

### C. Transfers of Title/Transfers of Physical Assets

Written Agency approval is required for transfers that involve the entire ownership entity. Since the original owner will not be relieved of liability under the loan in a transfer situation, transfers would probably only be proposed in an exceptional situation. The lender must conduct a review of property conditions prior to recommending the



transfer for Agency approval. All transfers of the entire ownership entity must include a plan to bring the property into full compliance with program requirements, and loan documents, including any physical repairs or deficiencies in reserve fundings.

## **SECTION 3: ASSET MANAGEMENT**

### **7.9 OVERVIEW**

Asset management involves regular monitoring of the operation and maintenance of a loan and security property to ensure that the value of the asset is maintained or enhanced over the life of the loan, taking into account market conditions. Asset management includes financial and physical management of the property and compliance with program and other Federal requirements.

### **7.10 FINANCIAL MANAGEMENT**

#### **A. Borrower Reports to the Lender**

The purpose of the borrower reporting requirements is to provide the lender with the information necessary to adequately monitor the guaranteed loan. The lender may require additional reporting for its own purposes. Borrower reporting requirements must be applied consistently to all GRRHP loans. The Agency also expects the lender to obtain additional information regarding the property through management reviews and physical inspections of the property. The lender must outline the complete reporting requirements and planned reviews and inspections in the servicing plan.

#### ***1. Annual Audited Financial Reports***

Within 90 days of the end of the project fiscal year, the borrower must submit to the lender an audited annual financial statement conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS). GAGAS will provide the lender with a financial audit of the property as well as information regarding compliance with program requirements. The program review requirements for the GAGAS audit can be found in Exhibit 7-2. In addition to this report, the borrower must also certify that they are in compliance with the rent restrictions established in [7 CFR 3565.203].



#### ***2. Failure of the Borrower to Comply with Lender Reporting Requirements***

The lender may require additional information from the borrower at any time if necessary to fulfill its reporting requirements to the Agency or to properly fulfill its oversight and monitoring responsibilities.

Failure on the part of the borrower to comply on a timely basis with the reporting requirements outlined in this handbook and any additional reporting requirements established by the lender in writing, may result in penalties against the borrower ranging from denial of surplus cash distribution to acceleration of the mortgage.

## **Exhibit 7-2**

### **Supplemental GAGAS Audit Guide**

- For years in which loan funds were expended, either outright or through interim financing, test expenditures to determine if they were budgeted and were made for only authorized loan purposes within the prescribed loan limits and limitations on the use of loan funds. Note: Testing should be expanded, as appropriate, for expenditures involving parties having an identity of interest with the borrower (related parties).
- Ascertain whether the GRRHP project is capitalized in the borrower's financial records at the total development cost, including the portion financed by the Agency and contributed by the borrower, less depreciation.
- Ascertain whether the borrower has written documentation supporting a request to, and prior approval from, the Agency for any changes in stockholders, general partners, or trustees.
- Ascertain whether there were any changes in limited partners, and if so, whether the borrower has written documentation supporting a notification to the Agency.
- For years in which the project is being constructed, ascertain by reviewing the borrower's financial records whether the borrower contributed the required percentage toward the project's development cost, and whether any cash contribution was expended prior to loan funds.
- Ascertain whether any liabilities were improperly charged to, or paid from, project operations for contributions made by the borrower equal to, or in excess of, the required contributions for development costs.
- Test whether funds disbursed from the accounts were for actual, reasonable, and necessary expenditures incurred for authorized purposes, and if required monthly debt service payments and transfers to escrow and reserve accounts were made. Disbursements made for purposes not related to the GRRHP project, including loans to other projects or enterprises, and partnership or corporate legal, tax preparation, and accounting fees, are not authorized or allowable. Note: Testing should be expanded, as appropriate, for expenditures involving parties having an identity of interest with the borrower (related parties).
- Ascertain whether the reserve account is current by comparing the actual amount in reserve to the amount that should have accumulated since the date the project began operation (see loan agreement), less any authorized withdrawals approved by the Agency. Obtain a confirmation of the reserve account balance from the applicable financial institution, also checking for any encumbrances against the reserves.

### **Exhibit 7-2 (Continued)**

- Ascertain whether a separate bank account is maintained for tenant security deposits, and if sufficient funds are in the account to cover security deposits collected from current tenants. Obtain a confirmation of the tenant security deposit account balance from the applicable financial institution, also checking for any encumbrances against the funds. Test withdrawals to ensure they represent either refunds to tenants or transfers to the general operating accounts for lease violations.
- If any surplus funds existed after payment of general operating expenses, debt service requirements, reserve account installments, and returns on investment, ascertain whether the borrower obtained written approval from the Agency for the disposition of such funds.
- Ascertain whether the borrower timely prepared and submitted audited financial statements for the previous year if required.
- For the tenants selected under the audit procedures, review the borrower's records to ensure there is an original tenant certification on file and the tenant's income was independently verified.
- Test the accuracy of the information and figures reported on the tenant certifications by reconciling the information and figures with the most current leases, independent income (earned, unearned, public assistance, etc.) verifications, and other information obtained by the borrower.
- Ascertain whether the borrower has a management plan, and a management agreement, if required, which have been approved by the lender.
- Test whether the management services provided, compensation paid, and other management-related expenses incurred were in accordance with the management plan and agreement.
- Ascertain whether the borrower is: (1) maintaining the required fidelity bond coverage; (2) maintaining adequate property, worker's compensation, liability, and flood (where applicable) insurance; and (3) timely paying real estate and other applicable personal property taxes.

### **B. Lender Reports to the Agency**

The lender must periodically report to the Agency on each GRRHP loan in its portfolio. These reports will provide the Agency with an accurate assessment of the condition of the guaranteed loan portfolio. The Agency will collect additional information on the lender's portfolio of guaranteed loans during the annual lender audit process. Periodic reports include those listed below.

## 1. *Annual Reports*

Within 120 days of the end of each project's fiscal year, the lender must submit a report to the Agency detailing their review of the project annual financial statements. The lender may use the Freddie Mac *Form 453* or an equivalent, and must highlight information on the following items:

- Unresolved audit findings;
- Outstanding physical and financial deficiencies. Such deficiencies should be ranked in accordance with the Agency Classification Scale (see Exhibit 7-3);

### **Exhibit 7-3**

#### **Classification System of RHS Projects**

##### Class A

No specific problems with project.

##### Class B.

Approved workout agreement in place and on schedule.

##### Class C

1. Unauthorized return to owner.
2. Required monthly/quarterly reports not submitted.
3. Deferred maintenance.
4. Below average rating from last lender inspection.
5. Unapproved workout agreement in place and on schedule.

##### Class D

1. Delinquent loan account.
2. Annual Financial Statement not submitted.
3. Delinquent reserve account.
4. Taxes not paid.
5. Insurance not paid.
6. High vacancy -- reduced rental revenue of 10 percent or more.
7. Health, safety or environmental problems.
8. Noncompliance with Equal Opportunity and Fair Housing requirements.
9. Unsatisfactory rating from last lender inspection.
10. Substantial deferred maintenance.
11. Unauthorized owner/manager agent withdrawal from project funds.


- Underfunded reserves and escrows, including:
  - ◊ Tax and insurance escrows, and
  - ◊ Replacement reserve levels below \$1,000 per unit;
- Current debt service coverage ratios below 1.15;
- Vacancy levels greater than the original underwriting level;
- Tenant income and family size characteristics; and
- Information on unit rent levels and average project rents for the period.

In submitting the information required above, the lender must also certify that the borrower is in compliance with the rent restrictions established in [7 CFR 3565.203].

## **2. Quarterly Reports**

The lender must submit a quarterly report to the USDA Finance Office using *Form RD 1980-41, Guaranteed Loan Status Report* to detail the current status of the GRRHP loan.

## **3. Monthly Reports**

The lender must submit monthly reports to the Agency on all loans in its portfolio which are in default or delinquent in meeting program requirements.  *Form RD 1980-44, Guaranteed Loan Borrower Default Status*, must be submitted to the USDA Finance Office for this purpose. The lender must also submit a monthly report to the State Office detailing:

- The reason for the delinquency;
- The physical condition of the property;
- The occupancy rate of the property;
- The amount of the delinquency;
- The corrective action plan being implemented to resolve the delinquency; and

- The workout plan (or a time frame when the Agency should expect a workout plan, if one has not yet been received) showing all non-compliance with program or loan requirements and actions and timetables for resolution.

All loans reported delinquent must be serviced in accordance with Section 4 of this chapter, including the development of a workout plan in accordance with Agency requirements.

#### ***4. Failure of the Lender to Comply with Agency Reporting Requirements***

Failure of the lender to comply with Agency reporting requirements in a timely manner may result in revocation of lender approval and the transfer of all GRRHP loans to another approved lender. If the lender fails to comply with the Agency transfer requirements, the guarantee may be cancelled.

### **7.11 COMPLETING THE LIFE CYCLE COST ANALYSIS AND RESERVE ANALYSIS**

The purpose of the life cycle cost analysis and reserve analysis is to ensure that reserve levels will continue to meet the expected capital repair and replacement needs of the property.

#### **A. The Life Cycle Cost Analysis**

A life cycle cost analysis must be completed during the underwriting of the project and reviewed by the lender at least once every five years (or more often if the lender requires). The Agency recommends that the lender use life cycle analysis to determine adjustments to the reserve level requirements in accordance with Paragraph 7.6 B.

#### **B. Adjusting the Reserve Deposit Requirement**

##### ***1. Increasing the Reserve Deposit***

On an annual basis the lender must review the reserve level and adjust the deposit requirements accordingly. If reserves have fallen below \$1,000 per unit, the lender should determine whether to require an increase in the monthly deposit amount to bring the reserve levels above this recommended threshold. In making this determination, the lender should weigh the need for the increased reserves against the financial security of the property.

## 2. *Decreasing or Suspending the Reserve Requirement*

In certain cases the lender may choose to decrease or suspend the reserve requirement. This might happen if:

- Reserve levels are adequate, based on the lender's assessment of the life cycle analysis for the property; or
- The property is financially troubled and in need of the amount deposited in the reserve account to meet other monthly expenditures (this situation should be documented in the workout plan).

The Agency should be notified, as part of the quarterly reporting process, of all cases where reserve deposits are suspended.

## 7.12 PHYSICAL MAINTENANCE AND OVERSIGHT

### A. Physical Standards and Inspections

#### 1. *Physical Standards*

The lender must develop standards for physical inspections consistent with industry standards. Construction Standards listed in RD Instruction 1924-A, §1924.5 (d) may be used as a guide.



#### 2. *Physical Inspection Reporting*

The lender must inspect each property on an annual basis and report the summary findings to the Agency as a part of the lender's regular annual report. The lender must use the *Form HUD 9822, Physical Inspection Report* to document the findings of the physical inspection and, when required by Paragraph 7.12 A.3., to report them to the Agency.

#### 3. *Responding to Deficiencies*

Lenders may allow borrowers 90 days from receipt of the lender's physical inspection report to resolve the deficiencies and/or submit a corrective action plan. If deficiencies remain outstanding beyond the 90-day period, the lender must submit the complete physical inspection report to the Agency along with the lender's proposed action plan for resolving the deficiencies.



### B. Capital Improvement Plans

It is the responsibility of the lender to establish standards for the development of capital improvement plans for each property. This format and process must be outlined in the approved servicing plan. A capital improvement plan must be developed by the



borrower if the lender determines that the property is physically troubled or if the Life Cycle Cost Analysis review process detailed in Paragraph 7.11 is no longer working. The Capital Improvement Plan (CIP) would then serve as the life cycle analysis for future annual assessments of the project's reserve levels.

If the lender determines the property has serious capital deficiencies, the lender must report the findings to the Agency and submit a CIP as part of the regular quarterly reporting process.

## **7.13 COMPLIANCE WITH OTHER FEDERAL REQUIREMENTS**

### **A. Affirmative Fair Housing Marketing Plan**

As a part of the lender's monitoring and oversight responsibilities, the lender will monitor compliance with the Affirmative Fair Housing Marketing Plan (*Form HUD 935.2*). If the lender discovers modifications are needed to the plan, such modifications should be suggested to the borrower. Borrowers who repeatedly fail to comply with the established plan must be reported to the Agency. Chapter 8 provides additional information with regards to this plan.



### **B. Annual Fair Housing Reporting Requirements**

Section 526 of Public Law 100-242 of the Housing and Community Development Act of 1987 requires the Administrator to assess the extent to which RHS housing and community facilities programs comply with the Federal Fair Housing Act requirements. The Agency will require lenders to submit a report from the borrower on fair housing compliance as part of the annual audit. This report should detail, for each unit, gross income, race, national origin, head of household, gender, elderly and disability status. This information is collected for statistical purposes only.



### **C. Other Civil Rights Laws**

Exhibit 7-4 shows other civil rights laws with which GRRHP loans must comply. Lenders must understand the provisions of these laws, and must have a management plan to monitor compliance by their employees, contractors, borrowers and management agents, as appropriate.

Interest credit is classified as Federal Financial Assistance. Therefore, borrowers with loans receiving interest credit must also comply with the civil rights laws in Exhibit 7-5.

In addition, all borrowers must sign an assurance agreement (*RD Form 400-4*) and will be subject to civil rights compliance reviews, regularly scheduled no less than once every three years. They must comply with the design requirements of the Uniform Federal Accessibility Standards, in addition to the HUD



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accessibility Guidelines and the ADA Accessibility Guidelines. In addition, borrowers who receive interest credit must provide reasonable accommodations to tenants and prospective tenants, at the expense of the borrower.



**Exhibit 7-4**

**Major Civil Rights Laws Affecting All  
Multifamily Housing Loan and Grant Programs**

- **American with Disabilities Act (ADA).** Guarantees equal opportunity for individuals with disabilities in employment, public accommodations, transportation, State and local government services, and telecommunications.
- **Equal Credit Opportunity Act (ECOA).** Prohibits discrimination in the extension of credit on the basis of race, color, religion, national origin, sex, marital status, age, income from public assistance, and exercise of rights under the Consumer Credit Protection Act.
- **Title VIII of the Civil Rights Act of 1968** (also known as the Fair Housing Act of 1988, as amended). Prohibits discrimination in the sale, rental, or financing of housing on the basis of race, color, religion, sex, national origin, familial status, or disability.
- **Executive Order 11246.** Nondiscrimination in Employment by Construction Contractors (and subcontractors) receiving Federal construction contracts and Federally assisted construction contracts in excess of \$10,000 – provides for equal employment opportunity without regard to: race, color, religion, sex or national origin. For purposes of this Executive Order, Federally assisted construction contracts includes any Federal program involving a grant, loan, insurance, or guarantee.
- **Executive Order 12898 — Environmental Justice.** Requires each Federal Agency to make environmental justice a part of its mission by identifying and addressing disproportionately high and adverse human health or environmental effects of its programs, policies, and activities on minority and low-income populations.

**Exhibit 7-5**

**Civil Rights Laws Affecting  
Federally Assisted Multifamily Housing Programs**

- **Section 504 of the Rehabilitation Act of 1973.** Prohibits discrimination in a Federally-assisted program on the basis of disability.
- **Age Discrimination Act of 1975.** Prohibits discrimination in a Federally-assisted program on the basis of age.
- **Title VI of the Civil Rights Act of 1964.** Prohibits discrimination in a Federally-assisted program on the basis of race, color, and national origin.
- **Title IX of the Education Amendments of 1972.** Prohibits discrimination on the basis of sex in education programs and activities receiving Federal financial assistance from Rural Development.
- **Executive Order 11063 as Amended by 12259.** Prohibits discrimination in Federally-assisted housing financing on the basis of race, color, religion, sex, or national origin.
- **Executive Order 11246.** Prohibits discrimination in employment by construction contractors (and subcontractors) receiving Federally-assisted construction contracts in excess of \$10,000. It provides for equal employment opportunity without regard to race, color, religion, sex, and national origin.

## 7.14 COMPLIANCE WITH OTHER PROGRAM REQUIREMENTS

### A. Regulatory Agreement Compliance

A regulatory agreement governing the relationship between the borrower and lender must be developed by the lender and executed by both the borrower and the lender. While the Agency will not be a party to the agreement, the agreement will state that the Agency may assume the role of the lender if necessary to force borrower compliance with the agreement.

In the case where the Agency assumes the property in the role of mortgagee-in-possession (MIP), the regulatory agreement will remain in force at the Agency's sole discretion.

The regulatory agreement must be transferable from lender to lender in the event that the property or the guarantee is transferred to an Agency approved lender.

This agreement must, at a minimum, stipulate the following:

- That it is binding upon the borrower and any of its successors and assigns, as well as upon the lender and any of its successors, and assigns and assigns for the duration of the guaranteed mortgage.
- That the borrower must make all payments due under the note and all payments to required escrows and reserves for future capital needs.
- That the borrower must maintain the project as affordable housing in accordance with the purposes and for the duration defined in the statute.
- That the borrower must maintain the project in good physical and financial condition at all times.
- That the borrower must maintain complete project books and financial records, and provide the Agency and the lender with an annual audited financial statement within 90 days of the end of the project's fiscal year.
- That the borrower must make project books and financial records available for review by the USDA Inspector General, Agency Staff and the General Accounting Office (GAO) or their representatives, upon appropriate notification.
- That the borrower must comply with the Affirmative Fair Housing Marketing Plan and all other Fair Housing requirements.



- That borrower must comply with Civil Rights laws affecting Federally assisted multifamily housing programs and the Americans with Disabilities Act.
- That the borrower must operate as a single asset ownership entity.
- That the borrower must comply with applicable Federal, State and local environmental laws.
- That the borrower must provide management satisfactory to the Agency and comply with the lender-approved management plan and agreement for the property.
- That the borrower will work with the lender in a workout situation.

## **B. Preservation of Affordable Housing**

For the period of the original term of the guaranteed loan, the housing must remain available for occupancy in accordance with [7 CFR Part 3565, subpart E]. This applies unless the housing is acquired by foreclosure or an instrument in lieu of foreclosure, or the Agency waives the applicability of this requirement after determining that the following three circumstances exist.

- There is no longer a need for low- and moderate-income housing in the market area in which the housing is located.
- Housing opportunities for low-income households and minorities will not be reduced as a result of the waiver.
- Additional Federal assistance will not be necessary as a result of the waiver.

All requests for removal of the affordable housing restrictions must first be made to the lender. The lender must assess the housing using the three criteria above and forward the borrower's request to the Agency, along with the lender's assessment of the property's compliance with the above tests. The State Director will make the final determination as to whether the income restrictions may be terminated.

## **SECTION 4: SPECIAL SERVICING**

### **7.15 OVERVIEW**

In accordance with Paragraph 7.7, the lender must begin special servicing actions when a property is in default of the guaranteed loan.

## 7.16 ROLES AND RESPONSIBILITIES OF THE SERVICING LENDER

### A. Development of a Workout Plan

At a minimum, a workout plan must be submitted to the Agency using the 515 workout plan format (see Exhibit 7-6) no later than 60 days after the lender has notified the borrower that they are in default under the regulatory agreement.



#### Exhibit 7-6

##### Information to be Included in a Workout Agreement

**Background information.** This section describes the project's location, type, and size.

**Description of the problem.** This section identifies the project's deficiencies and needs, including specific compliance and financial concerns. It should identify the basic causes of the difficulties.

**A plan to correct deficiencies.** This plan must include the following information:

- Borrower actions needed to correct the problem(s).
- Resources needed in order to accomplish the correction, including those that will come from the lender and those that will come from the borrower.
- A timetable for taking action and applying the resources.
- A summary of the anticipated outcomes.

**Agreement by borrower to provide periodic financial statements** , including any income and expense reports and bank statements, if appropriate.

**The signature of the borrower and the lender on the workout agreement .**

**A request for Agency consideration .** (The State Director or designated State staff will approve the agreement.)

Once the lender has submitted the workout plan for Agency review, the lender and the borrower will be considered in compliance with the terms of the note for the purposes of the claims process outlined in Chapter 10. The timeframes for submission of a claim and the disposition plan will not be applicable unless the borrower (or lender) falls out of compliance with the approved workout plan or if the workout plan expires before the borrower cures the default.

If the lender chooses not to pursue a workout agreement with the borrower, the Agency will review this action prior to approval of the liquidation plan.

## **B. Bankruptcy of Borrower**

The lender is responsible for protecting the guaranteed loan and all collateral securing the loan in bankruptcy proceedings. These responsibilities include, but are not limited to, the following:

- The lender must file a proof of claim where necessary and all the necessary papers and pleadings concerning the case.
- The lender must participate in meetings of the creditors and all court proceedings.
- When permitted by the Bankruptcy Code, the lender must request modification of a reorganization plan whenever it appears that additional recoveries are likely.
- The lender must keep the Agency adequately and regularly informed in writing of all aspects of the proceedings.
- The lender must take whatever reasonable affirmative action is necessary to protect the interest of the government including motions to dismiss, exceptions to discharge, and objections to exemptions.
- In a Chapter 11 reorganization, if the Agency determines that an independent appraisal of collateral is necessary, the lender must obtain an independent appraisal report set forth in Chapter 3.

## **C. Loss Claims During Bankruptcy**

When the loan is involved in reorganization proceedings, payment of loss claims may be made as defined in Chapter 10.

## **7.17 ROLES AND RESPONSIBILITIES OF THE BORROWER**

This paragraph details the borrower responsibilities with regards to the workout plan.

### **A. Submission of Information to the Lender**

During special servicing actions and the development of a workout plan, the lender may request information from the borrower in addition to what they are already receiving on a quarterly basis. The borrower's failure to comply with the lender's request could result in a technical default under the regulatory agreement.

### **B. Development and Execution of the Workout Plan**

The borrower must work with the lender to develop a workout plan for the lender's approval. This plan should be completed and ready for lender approval 30 days of the date of default, in order to ensure that the lender has





adequate time to approve the plan and submit it to the Agency for review. In developing a workout plan, the time frame for conclusion of the plan should not exceed 2 years. Extensions to that timeframe may be approved by the Agency on a case by case basis.

### **C. Compliance With the Workout Plan**

Once a plan is established a borrower will be considered to be in compliance with program requirements so long as they remain in compliance with the workout agreement. While the lender must report to the Agency monthly on the property, the timeline for submission of a claim and a liquidation plan may be delayed until such time as the workout agreement expires or the borrower fails to comply with its terms.

If a borrower fails to comply with the terms of the agreement, the property will be considered in default and the lender must begin processing a notice of liquidation. These procedures are outlined in Chapter 10.

## **7.18 SPECIAL SERVICING OPTIONS**

A workout or special servicing plan may utilize any of the following tools to bring the loan into compliance. If a plan requires modification to the guarantee or a payment of claim by the Agency, the Agency must approve such action.

### **A. Loan Modifications**

A loan modification requires Agency approval. A loan modification would include any change in the amount or term of the guarantee:

- Reamortizing to extend the term of the current loan or
- Writing off a portion of the debt.

### **B. Partial Payment of Claim**

A partial payment of claim is another tool that may be used to workout troubled loans. Under a partial payment of claim, the Agency pays a claim on a portion of the guaranteed loan, thereby reducing the debt that must be amortized. Partial payments must be approved by the Agency prior to the execution of the workout plan.

The Agency reserves the right to require the attachment of a second lien on the property for partial claims paid if the original ownership entity remains in place. If a change in the entire ownership entity is a condition of the workout plan, the Agency will not attach a “soft second” note to the property for a partial claim amount.

If a partial payment of claim is approved, the claim will be processed in accordance with the procedures outlined in Chapter 10.

### **C. Transfer of Physical Assets**

A transfer of physical assets is a sale, gift, or other transfer of the property to another party where the original loan remains in place. In a special servicing situation, the transfer of physical assets (TPA) must be approved as outlined in Paragraph 7.8. All other changes in the ownership entity must be approved by the lender and recommended to the Agency for concurrence. Although a transfer and assumption is normally considered loan servicing, it should be processed in the same manner as a new loan.

### **D. Agency Approval of Reserve Releases**

The Agency reserves the right to control reserve releases in a special servicing situation. Requests for the use of reserve funds on a workout plan must first be approved by the lender. On a case by case basis the Agency will review requests for uses of reserve funds outside the scope of the eligible uses (e.g. use of reserve funds to pay taxes). In these situations, the borrower must submit the request to the lender. The lender will forward the request and any supporting documentation to the Agency with its recommendation. These requests will be approved on a case-by-case basis in the servicing office.

### **E. Lender Recommendation of Enforcement Action**

In situations where the lender believes that the borrower is in violation of regulatory requirements, the lender may recommend that the Agency take enforcement action against the borrower. Such actions may include suspension, debarment, limited denial of participation, or other judicial remedies.